ENFORCED PAR REMITTANCE UNDER THE FEDERAL RESERVE SYSTEM

SUMMARY

Another chapter in check collection is rapidly nearing completion. By its decision of May 16, 1921 in the case of the American Bank and Trust Company versus the Federal Reserve Bank of Atlanta, the Supreme Court has pointed the way to the close of a noteworthy experiment in banking collection systems.

Starting from the vague provisions of the Federal Reserve Act, unchecked by bankers' protests, state laws, or Congressional acts, the Federal Reserve Board since its inauguration in 1914 had almost succeeded in transforming the clearing and collection system of the country. However a group of southern bankers, embittered by what they believed to be domination by the reserve banks, brought the federal reserve collection policies before the courts; resulting in a decision which doubtless will renew the irregularity in the basis of collections. A large share of the responsibility for this failure may be laid to the inclusion of "par collection" in the plan; contemplating an interference with the "sacred right of profit" of country banks. "Par collection" is the obtaining of remittance on checks from a drawee bank at face value. This was proposed as a remedy for the "kiting" of checks as well as a stimulus to their usage.

With the idea of establishing a collection system of this type, the federal reserve banks demanded that every check sent by them to drawee banks be settled for at face value, the customary charge for remittance — "exchange" — being eliminated. However, as a bank's obligation is to pay demand orders on itself only over its own counter the question which the opposition brought before the Supreme Court was: Has a federal reserve bank the legal right to compel par payment of a check in another city?

The collection problem has long been troublesome to all concerned — the customer of a bank wanting par credit on all checks which he deposits, the banker in turn himself desiring the same from correspondents. As there is definitely a cost to be met in handling checks due to the loss of interest while uncollected as well as to expenses incurred in obtaining remittance, someone has to meet the bill. In some cases it has been the banker, in others the customer.

When immediate credit is given on an uncollected check, no exchange being charged, a loan without interest is made by the bank to the customer. In order to offset the cost thus incurred it became customary among banks to open correspondent accounts with each other under arrangements whereby par collection of checks could be obtained in return for the leaving of substantial balances. Since the larger city banks were especially fitted for the handling of such accounts they took over the problem of obtaining remittance on the checks of country banks.

However, in paying checks drawn upon themselves the latter were inclined to deduct a charge varying from one-tenth of one per cent to one-half of one per cent for the service of remitting. City banks were not usually

able to claim this source of income, the difficulty being not in any different rights or obligations but that most demand orders came in over their own counter for payment.

By many it was believed that the passing of the Federal Reserve Act late in 1913 would put an end to these irregularities and establish for the country one complete and adequate collection system. For instance, Representative Glass in 1914 stated that the effort to eliminate exchange charges had been resisted "with utmost pertinacity" but that Congress by the act had eliminated the wastefulness incident to many independent collection organizations, and had torn down the "toll gates upon the highway of commerce." [1]

What the act contained was a provision allowing the Federal Reserve Board to form a collection system for member and federal reserve banks; the reserve banks to receive checks at par from member banks and charge them for services rendered in clearing or collecting. Member banks were in turn allowed to charge federal reserve banks an amount at least equal to the costs of collection and remittance of checks sent by the latter.

The Federal Reserve Board was thus given wide powers in prescribing the details of the collection system to be established, being limited only by the fact that checks must be received by reserve banks at par and that a member bank might not be prohibited from "charging its actual expense incurred in collecting and remitting funds." [2] The Board proceeded cautiously however, in order, as stated in the first Report, to gain "the harmonious coöperation of banks involved." [3] After a number of conferences and the consideration of several plans, it was decided to experiment, beginning

1. Report of the American Bankers Association, 1914, p. 117.
2. Federal Reserve Act as approved December 23, 1913, Section 16.
3. Federal Reserve Board, Report, 1915, p. 14.

December, 1914 in two districts, St. Louis and Kansas City, with a system of enforced par clearing; the Board having concluded it inexpedient to force an undesired measure upon all member banks at the same time. The experiment under trial made a federal reserve bank a clearing center for its district, immediately charging the account of a bank at par for checks drawn upon it, and crediting it at par for remittances.[4]

Much dissension arose under this system due to its compulsory nature, so that on June 15, 1915 it gave way to a voluntary plan of the same type;[5] the Federal Reserve Board believing that a more favorable attitude would be attained if the pressure of participants alone forced reluctant banks to coöperate. Member banks, however, did not respond with the alacrity that was desired, only 25 per cent having joined in the first month. Consequently the federal reserve banks were in doubt as to the best method of procedure; the majority thought a mandatory system necessary.

A committee of federal reserve agents, formed to consider the subject of collections, came to the conclusion in October, 1915 that the problem was one of reserves rather than of transit facilities, recognizing that little could be done in the establishment of a collection system until the reserves had been transferred to federal reserve banks from reserve agents, thus ending the tangle of reciprocal collection arrangements. In June, 1916, as a result of the findings of the Committee, a plan was adopted, effective July 15, 1916. In general the provisions then outlined are still in effect and form the center of the present controversy.

4. No charge was made by the federal reserve banks for their services.

5. This was adopted in all districts except Kansas City, where the compulsory system still prevailed.

Perhaps the most important recommendation of the Committee was to begin a system of deferred credit by which checks would become available as reserve at federal reserve banks in accordance with a schedule on which was figured the average time necessary in obtaining collection from a particular locality. The member bank depositing checks would thus wait until the drawee bank had time to receive, examine, and remit before credit would be given on the deposit.[6]

The plan further provided that: (*a*) the sending of checks by member banks to federal reserve banks be voluntary, (*b*) all members be compelled to pay without deduction checks drawn on them sent by the federal reserve bank of their district, (*c*) all members be allowed to deposit such checks as could be collected at par, (*d*) the expense of transmission of funds be borne by federal reserve banks.

The hope that fifteen thousand banks would be included on the collection list was very nearly realized, for 14,656 joined the first month, followed by consistent gains. As there were at this time less than eight thousand members of the federal reserve system, about one-half of those on the "par list" were non-member banks. In influencing the latter to remit at par, use was made of two effective devices: (*a*) presentation by institutions in the locality of the drawee bank, (*b*) tendering of checks for cash payment over the counter of the drawee bank by employees of a reserve bank. Indeed, par remittance by mail was not usually attained through any desire on the part of a non-member bank to secure the advantages coming from affiliation with a unified collection plan. Non-members failed to look upon the

6. It is worthy of note that at this time the Federal Reserve Board abandoned its par collection plan, in that postage or express was allowed to be deducted from remittances, and in addition a deferred payment obtained by the reserve banks. The subsequent plan may more accurately be described as a par remittance system.

curtailment of their exchange profit as "slow education" — the term employed by federal reserve officials.

So it was that federal reserve banks employed institutions and individuals as means of forcing par payment. Most important as collection agencies were banks and express companies, altho the services of both were rendered incomplete since they did not have offices in every city or town where a non-par remitting bank was located. However the use of banks had the added advantage of being both inexpensive to the federal reserve bank and serviceable to the agent bank; the latter being able to obtain the usage of the proceeds of checks during the time elapsing between par payment, obtained over the counter of the non-member, and the charging of the draft in settlement against the reserve city account of the agent bank. But the final and supposedly clinching method of pressure was direct presentation by traveling agents hired by a federal reserve bank, payment to be accepted in currency only. The expense involved in such presentation, however, rendered it expedient only when others failed or were impossible of application. The call for cash over the counter of a bank made it exceedingly difficult to keep an adequate amount on hand to meet all the demand obligations that the federal reserve bank might tender, especially if several days elapsed between days of presentation. The earlier method of payment had been by exchange on a reserve city resulting in the keeping of a considerable balance with reserve agents. This balance, however, was not available to meet a current demand for cash. Consequently, an objecting non-member would have to withdraw cash in order to protect itself from embarrassment, thus foregoing interest that would have been received on a reserve city account.

One by one the non-members gave in, preferring to

lose the exchange profit which they had previously deducted from remittances rather than suffer the inconvenience and expense caused by direct presentation. As would be expected, the federal reserve system was none too popular among non-member banks; this resentment being voiced in resolutions of bankers' associations, bills presented to Congress, state laws, and newspaper articles as well as injunctions. Member banks were also for the most part only too glad to cooperate in the movement to have the federal reserve collection policies changed, for many of them too were suffering a loss of exchange.

Within four months after the formation of the enforced par remittance program of the Federal Reserve Board, the American Bankers' Association in its 1916 meeting went on record almost unanimously in opposition and formed a committee to urge upon Congress and the Reserve Board the necessity of "reasonable charges." As a result of the protests, Senator Hardwick on May 9, 1917 offered a "rider" to the bill then under consideration in the Senate to amend the Federal Reserve Act, legalizing exchange charges to the amount of one-tenth of one per cent. After considerable discussion, the bill as amended was passed by a scant margin. The Senate and House bills as passed not being identical, a conference committee was appointed to secure uniformity. Before this committee had acted, the House hearing of the Senate's action in adding the Hardwick Amendment, voted at the suggestion of Representative McFadden to instruct its conferees to "agree in substance" with the Hardwick Amendment. While the matter was under consideration in the committee, however, much pressure on the part of credit men's associations, wholesale and retail merchants, city bankers,

and federal reserve banks was brought to bear against this amendment. Even President Wilson wrote asking that this section be removed from the bill.

Consequently the committee,[7] despite the instructions to include the Hardwick Amendment in the Conference Bill, amended it to read: "That nothing in this or any other section of the Act shall be construed as prohibiting a member or non-member bank from making reasonable charges, *to be determined and regulated by the Federal Reserve Board*, but in no case to exceed ten cents per $100 or fraction thereof, based upon the total of checks and drafts presented at any one time, for collection or payment of checks and remission therefor by exchange or otherwise; *but no such charges shall be made against the federal reserve banks*."

This report coming before the Senate met with immediate opposition, Senator Hardwick insisting that the substance of the section had been completely altered. Senator Owen, however, speaking for the committee, claimed that the measure could in no way affect the actions of non-member banks, who were the chief objectors to the passing of the conference bill. The result was that the Senate acted favorably upon the Report and on June 14th it came before the House. There again the committee received severe criticism for adding words to nullify the Hardwick Amendment, agreed upon by both the House and the Senate. The measure was however passed, the President signing it on June 21st.

From that date, the federal reserve banks began, even more extensively, the move to establish a "universal par collection list": one that would include both member and non-member banks. Failing to accept the interpretation of Congress on the Hardwick Amend-

7. It is interesting to note that five out of the six members of the Conference Committee had previously gone on record in opposition to exchange charges.

ment, the Board looked upon it as "a mandatory requirement that non-member as well as member banks shall remit absolutely at par,"[8] later stating the reason for this interpretation to be that "the federal reserve banks are affording all member banks certain reciprocal advantages in the collection and clearance of checks and because the federal reserve banks are obligated to receive checks at par, they may properly expect remission on the same basis."[9] Meanwhile the Attorney General had ruled that federal reserve banks might not pay exchange.[1] But, instead of failing to accept checks drawn upon non-member banks known to be in the habit of deducting exchange charges, the federal reserve banks chose to put into effect a policy designed to make them pay remittance letters at par.

So despite the opinion of the Attorney General and the intent of Congress that the provisions of the Amendment of June 21, 1917 did not apply to state banks not connected with the federal reserve system as members or depositors, the reserve banks set out to make every state an "all par state." Their position is well stated by a committee of federal reserve agents: "The banks and the public need a system that is able to collect all items. The par collection system is not a local or selfish undertaking for the benefit of member banks, but is a national enterprise for the convenience of the public, and the promotion of commerce, and concentrated and persistent efforts will be made to make the par list complete."[2]

The success of these attempts is testified to by the fact that from July, 1917 the number of non-member

8. Federal Reserve Bulletin, 1917, p. 501.

9. Ibid., p. 662.

1. See letter of Attorney General, Report of Federal Reserve Board, 1918, p. 76.

2. Report of Federal Reserve Board, 1918, pp. 75, 76.

banks remitting at par underwent a steady increase until in January, 1921 over 91 per cent were on the "par list"; the remainder being small unaffiliated state banks in the South, where the federal reserve banks were only just beginning their "educational process."

But this result was not amicably attained. Bankers' associations were ever willing to condemn the federal reserve action, altho few cared to carry the protest into court. As the reserve banks started their program in the South, opposition took the definite forms of: (*a*) an attempt by legal process to restrain the federal reserve banks from collecting at par, (*b*) the influencing of state legislatures to pass laws upholding exchange charges on remittances, (*c*) the attempt to obtain a change in the national statutes, definitely legalizing exchange, (*d*) the bringing of pressure to bear on the Federal Reserve Board and banks to obtain a reversal of their policy.

The legal battle came as a result of the ill-fated campaign of the Federal Reserve Bank of Atlanta to enforce par remittance. Governor Wellborn of this reserve bank had in December, 1919 set out to put all non-member banks in the Atlanta District on the "par list," a step already accomplished in the majority of the districts. Unfortunately for the reserve bank there was included in his letter to non-members asking for par remittance the statement that he "would very much regret to adopt other methods of collection that would prove embarrassing, annoying, and expensive" to banks not coöperating. In response, a number of banks headed by the American Bank and Trust Company filed a bill in equity in the Fulton County Court of Georgia "denying the right of the Reserve Bank to assume jurisdiction over them and coerce their action."

As relief, an injunction was asked permanently restraining the Federal Reserve Bank from collecting checks drawn on the plaintiffs except "in the usual and ordinary channel of collecting checks through correspondent banks or clearing houses."

The case was removed to the United States District Court for the Northern District of Georgia upon the motion of the defendant, the Federal Reserve Bank of Atlanta, where it was heard on its merits; a restraining order being granted the plaintiffs pending the hearing. At this hearing, it was alleged that the methods which the Federal Reserve Bank of Atlanta intended to put into use were "tyrannical and *ultra vires* the charter of the Reserve Bank" and employed to make the country banks render a valuable service without compensation.

In defense, the Federal Reserve Bank asserted its unqualified right to collect by any method checks backed by sufficient funds; it being the contract of the drawee bank to pay on demand. Since federal reserve banks were by their charter (the Federal Reserve Act) prohibited from making payments to remitting banks for services, the Atlanta Federal Reserve Bank was disabled from collecting through the regular channel of correspondence or clearing as long as a bank insisted on deducting the cost of remittance. Thus they maintained that they were forced to adopt other methods of obtaining collection.

The result was that on April 3, 1920, the United States District Court for the Northern District of Georgia affirmed the right of the Federal Reserve Bank to obtain collection by agents. This decision was affirmed by the United States Circuit Court of Appeals, Fifth Circuit, to which it was appealed. When, however, the matter came before the Supreme Court of the United States the decrees of the lower courts were reversed; the higher

court holding that if the plaintiffs could establish the purpose of the Reserve Bank to be to break down the business of the former as now conducted, a permanent restraining order should be granted. On this question of fact the case is now in the Northern District Court of Georgia where doubtless the plaintiffs will be successful, as they have the written statement of the Governor of the Federal Reserve Bank of Atlanta that failure to co-operate with the federal reserve system would cause annoyance, embarrassment and expense.

Destined probably to less success than litigation is the effort to obtain effective authorization of exchange charges by state legislatures. The difficulty is not that state legislatures are unwilling to pass bills to secure this end, but that the laws enacted are either discriminatory as between persons, or attempt to make checks legal tender for some purposes, resulting in unconstitutionality. Within thirteen months, laws for the purpose of allowing exchange charges went into effect in eight states: Mississippi, Louisiana, South Dakota, Georgia, Alabama, North Carolina, Tennessee, and Florida. A test case is now before the Superior Court of Union County, North Carolina, where a decision will be handed down on the constitutionality of the North Carolina law. Altho any verdict on the Georgia case will not settle the point at issue in the North Carolina dispute, it will doubtless be true that if a final judgment is given on the former favorable to the non-member bankers, proceedings will stop in North Carolina.

Foremost among those urging the continuation of exchange charges is the National and State Bankers' Protective Association, formed in February, 1920 to unify the action of those opposing par remittance. Largely through their efforts the exchange laws of the various states were passed and pressure brought to bear

upon Congress and the Federal Reserve Board. Congress, however, failed to act favorably upon the bills and resolutions presented to it, and the Federal Reserve Board took the matter none too seriously; Governor Harding of the Board stating that "a diversion of this sort is entertaining in a way, because it diverts our mind from the serious problems that are ahead of us." [3] The Association nevertheless succeeded in bringing the issues clearly into view for the first time.

Today the dream of universal par remittance is fading. The peak of the "par list" was reached the first of last year, and the number is slowly being diminished as banks take advantage of rights granted them under injunctions. Not yet, however, has the struggle been terminated. Both sides await the decision of the Supreme Court on the question of fact in the Georgia case. Altho it has indicated a stand in favor of non-member banks, this is not conceded by federal reserve officials. However, if the non-member banks gain a favorable decision it is probable that member banks will be accorded the same rights through an amendment of the Federal Reserve Act, since the Board has pledged itself to equality on this question. The close of the contest has not been reached but the way is indicated toward a return to the irregularities of the collection system of ten years past.

If, then, the federal reserve collection policies are about to be terminated, there seems no substitute plan adequate to the need. Congress cannot greatly help for its mandates can apply only to member banks, outnumbered two to one by non-member institutions. So the prospect of a unified collection system seems even as dark as in the days when the Owen-Glass Bill was in the

3. Hearing on H. Res. 476, Rules Committee, 66 Cong., p. 56.

period of formation. There are, however, possibilities in the present situation. If the Federal Reserve Board is able and willing to modify its collection program to act in the capacity of a unified agency, collecting under an arrangement agreeable to most banks, much benefit will inure to banks and to commerce.

Such a plan might provide that: (*a*) it be entered into by all member or non-member banks desiring affiliation; (*b*) each bank be permitted to deduct an agreed per cent (i. e., one-eighth of one per cent) from all remittance letters for exchange, nothing to be allowed as at present for postage or express on remittances;[4] (*c*) federal reserve banks accept checks on deposit in either of two ways: (1) for credit to the amount of the face of the check, this to be deferred for the average period necessary to secure remittance, (2) for immediate credit, exchange to be charged based on the amount of the check and the number of days necessary for collection; (*d*) the federal reserve banks assess a service charge against each bank collecting through the system, based upon the total of checks sent each month to the reserve banks, covering costs incurred in collection, including adequate compensation for the services of the reserve banks.

The more obvious advantages of this arrangement lie in the decreasing through quick collection of the large uncollected funds accounts — the float — and in the forming of centers where checks may be discounted for immediate credit. Equally important, however, is the bringing together of member and non-member banks on a coöperative rather than a compulsory basis of "slow

4. It might well be urged that if a uniform rate were fixed, applicable to all banks, injustice would be worked on those at a distance from a reserve city. Perhaps a service charge varying with the location of a bank would be the remedy. For other suggestions see letter of the Committee of Five of the American Bankers Assn. to the Federal Reserve Board, March 12, 1918.

education." Admittedly much dissension would follow the adoption of this plan — especially after the recent coercion — but it would in all probability secure the support of the American Bankers' Associasion, giving it a fair chance of success.

The greatest difficulty, however, lies in the matter of reserves, for state and federal laws offer a variety of reserve requirements, serving to render difficult a sound collection basis. State banks hesitate to forego the interest and low exchange charges as well as credit on the legal reserve received from an account in a reserve city, and the banks holding such accounts regret the possible loss of a profitable connection. One escape from this lack of uniformity is for state banks to join the federal reserve system. Over 20 per cent of those eligible for charters have already taken this step. However, largely because of the severity of membership requirements, only one-quarter of the non-member banks of the country are eligible. If the largest obstacle to an increasing membership — the capitalization required — is lowered, the country will have no less sound banking.

A large share of the solution of the exchange problem, however, lies in the hands of the individual banker and the public. If both would recognize that a check drawn upon another city is not worth par, but is a loan until collection is obtained by the one advancing funds, much light would be thrown upon the collection problem. In the South and West especially it has been customary to deduct exchange largely from remittances and accept deposits of checks at par; the opposite being more nearly true of the other banks of the country. Banks aim to break even at least on exchange. In whatever form it be paid, whether by deduction from remittances, payment upon deposit, or by compensating balances, the charge still remains. Assuredly, the amount of the charge

should be made the subject of a comprehensive regulation, but this does not deny its justice.

Indeed both bankers and the public join in the benefits which would accrue from a unified collection system. Such a system may be obtained, if at all, by the coöperative effort of bankers under a plan which would not compel the performance of the remittance service at a loss, as did the par remittance program.

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